

STRATEGY & UNCERTAINTY: How scenarios can help

Quick Points: An overview in 60 seconds

We now live in a frighteningly unpredictable world. But not only is the world and therefore our business environment unpredictable, it is also reliant upon a new, surprisingly fragile network of geographically stretched processes and information flows.

Positively, these networks give businesses access to resources and markets that could not have been dreamed of 10 to 15 years ago. But this inter-connectedness also brings with it a downside. A small shock or disturbance somewhere, that would not have raised us from our sleep 10 years ago, could now wreck our businesses overnight - before we wake up. The current crisis in the banking sector is an example of the risks of "inter-connectedness". We are now witnessing events in this sector that, back in 2007, would have been thought of as inconceivable. The point is that our businesses are now more exposed to the unseen, that remote "once in 1,000 year event", than ever before.

This briefing explains how an under-utilised technique - scenario planning - can help us to prepare for life in a globally inter-connected world. I will focus on explaining how this approach can be used in a business context and in a way that will not absorb too much of your precious time and resources but that will stimulate debate within your organisation.

Welcome to Uncertainty

A quick review of just one edition of the *Financial Times* (I have taken Friday 25th April 2008 as an example), reveals that we now live a world of sudden, unforeseen shocks. Predictability appears to be a characteristic of the past. Thumbing through the pages of this edition of the FT over a cup of coffee showed me a range of potential headaches, that probably were not on our strategy radar screens in September 2007, when many of us would have been embarking upon the traditional, well established, annual planning cycle.

The headaches that I could see just in this one issue included:

- § The prospect of a long-term recession led by structural failings in the financial sector.
- § Capital rationing.
- § Global food shortages and the prospect of food wars especially in emerging economies.
- § Doubts over the wisdom of turning to biofuels as an alternative to fossil fuels.
- § Diversity and fragmenting consumer values.
- § Ever shortening product life cycles especially in the consumer electronics sector.
- § The rise of national protectionism in the face of the new acquisitive kid on the block – the "sovereign wealth fund".
- § The emergence of anti-Western sentiments in China with Western brands taking the brunt.
- § The prospect of a new wave of increased regulatory supervision.
- § Question marks regarding the financial solidity of the banks that we have long accepted as cornerstones of a profit focused economic system.

Basing a business plan upon just one picture of the future, which is probably an extrapolation of the relatively comfortable past, won't work any more. Neither will the annual planning cycle where plans are set that are cast in stone (or Excel spreadsheets) for 12 months ahead. Both these techniques are too slow, blinkered, cumbersome and inflexible for our unpredictable world.

But there is another important point to make.

The world has changed in a fundamental way during the last 10 years. Cast your mind back to 1998. Many of the organisations that I dealt with 10 years ago didn't have e-mail. I used a guaranteed next day delivery service, or courier, to deliver my paper based reports. Now it's by e-mail. Also, back in 1998, not many organisations had integrated their central IT systems into the Web. Those green screen systems stood secure behind real, solid, highly tangible, brick walls. Now these core systems, the information lifeblood of the organisation, are reliant upon the Web. Global outsourcing too was yet to take off back in 1998. Few, especially in the financial services sector, had even thought of Asia as a new home for traditional tasks and processes.

Value chains, information flows and processes that were once geographically concentrated are now spread out across thousands of miles.

All this produces a globally interconnected world. We are all sewn together, through a network of digital information flows and geographically stretched value chains. This creates a network of inter-connectedness, efficiency and flexibility but also exposure. A once in a 1,000 year event that wouldn't have worried us 10 years ago could now, through this network of inter-connectedness and reliance, really upset our businesses. These globally stretched chains also expose us to new risks, including political and economic uncertainties, that we wouldn't have thought of considering 10 years ago.

So the challenge is, how can we manage these new uncertainties?

Looking at the wrong indicators

We have spent so much time over the last decade constructing measurement systems (e.g. the Balanced Scorecard) to help us monitor primarily the internal status of our businesses that we have forgotten to monitor the outside world.

To reinforce this point, a recent research survey noted that over 90% of organisations do not have a system to scan the external environment. The same research also told us that even in those companies that did have a system to scan the external world, the vast majority of managers were dissatisfied with their capabilities to predict the next "jolt".

But it is the forces and influences emanating from outside the organisation that will, ultimately, lead to either its success or its downfall.

Future success in an inter-connected world therefore will depend on the ability to create resilience and prepare for the unexpected.

One of the principal tools that we can use is scenario planning, a tool that can help us see our world, our business environment, from a different perspective. Instead of focusing our plans around just one view of the future, we can, through the use of scenario planning, consider a range of possible futures.

Broadening the corporate mindset

But arguably the first challenge is to broaden the corporate mindset.

We have all been trained to focus on one path, one picture of the future and, of course, one broad goal. Now we need to take a different course and develop:

- (i) a wider awareness of the range of possible futures that we could face and
- (ii) a range or portfolio of strategic opportunities matched to the range of futures and uncertainties that we face.

Thinking not just about one future marketplace but a range of possible future marketplaces is the first step in both changing the corporate mindset and managing uncertainty. The process of generating pictures of a range of possible futures is known as scenario planning and is an established, but under-utilised tool to help organisations manage and prepare for uncertainty.

One of the pioneers of scenario planning was Shell Oil who famously used scenario planning to help speed its reaction to the 1970s oil crises.

What is scenario planning? What are business scenarios?

It is best to start by looking at what business scenarios are *not* and how they differ from conventional business planning approaches.

Business scenarios are not:

(a) *A forecast*. Business scenarios are not definitive predictions. They are a range of possible views that should attempt to illustrate the range of future environments that we may face.

(b) *About certainty*. Scenario planning lets the organisation explore and debate the unknown – areas and situations that it has not faced before. Areas where there is a general feeling that if something happened the business might be hit hard, or could prosper, but there is very little knowledge or certainty about the probability or form of the event.

(c) *Quantitative*. This is a personal view. My personal viewpoint is that scenarios are qualitative descriptions of the future. You will find scenarios that are quantitatively based, possibly founded on a large number of complex computer simulations. I have reservations regarding the use of such quantitative projections. There is always the danger that when people see numbers (i) they believe that they are real, not illustrative and (ii) they may not appreciate that there may be great uncertainty regarding the availability, quality and parameterisation of the underlying data used to produce the projections. In short, numbers have a seductive Svengali-like pull, we are somehow persuaded to think that they are representations of the real world, when they are just pictures or illustrations.

But scenarios *are* descriptions of a range of futures that managers, leaders and staff in organisation feel that they may face.

The characteristics of scenario planning versus conventional business planning are contrasted in Illustration 1 below.

ILLUSTRATION 1: SCENARIO PLANNING vs. CONVENTIONAL BUSINESS PLANNING

Characteristic:	Conventional Business Planning:	Scenario Planning:	Comments/Observations:
Timeframe:	1 - 3 years.	5 - 25 years	Select a period of between 7 - 10 years for <i>business</i> scenarios. This is a long enough period for "shaping forces" to have an impact, but not too long as to be regarded as an abstraction.
Qualitative vs. Quantitative:	Significant quantitative component. "Single point" quantitative objectives.	Can be both. Quantitative outcomes usually expressed in ranges.	Suggest use of qualitative scenarios or stories. Especially if you are new to the process.
Views of the future:	1	Multiple. Typically 2-5.	If using 3 scenarios beware of being overly influenced by the "middle" scenario. For this reason some use just two scenarios.

Characteristic:	Conventional Business Planning:	Scenario Planning:	Comments/Observations:
Primary Purpose:	Business direction, control.	Challenging perceptions. Developing a portfolio of opportunities.	Single goal control vs. developing a range of potential actions and opportunities. Business plans answer the question "What are we going to focus on?" scenarios answer the question "What do we do if?"

Business scenarios can be as short as a single side of A4. They don't have to be large wordy documents and their construction doesn't necessarily have to absorb a lot of time.

How do we build scenarios?

The real reason why scenario planning is not used more often is that there is a great deal of confusion over the methods that can be used to create scenarios.

There is also the worry that scenario building will soak up time and resources. I will try to show here that scenarios can both be produced quickly and can rapidly stimulate debate about the futures that you think your organisation may face. The process that I will describe is based largely on my own personal experience of scenario building.

My scenario building process looks like this:

Step 1: Global conditioning: Many scenario building efforts start by asking managers in the organisation what their worries or issues are. A reasonable, but potentially flawed starting point. If you talk to your colleagues about their concerns before you ask them to undergo a "conditioning" process, you will just get the problems and issues that are a product of their past industry or marketplace experiences. In other words, more of the same. Looking at the past, as we have seen, won't help us think about tomorrow's uncertainties.

The conditioning phase is focused not on your local or industry marketplace but the possible directions that global environment could take. This type of debate helps to shake historic pre-conceptions, prejudices and perceptions. It is only when the possible shapes and forms of the global marketplace have been debated that your colleagues should start to talk about the worries that scenario building should address. This is not necessarily a long job as much work has already been done that is available on the Web.

Good places to start the global conditioning process are the Shell Scenarios 2005 – 2025 and the Global Risk Network's 2008 report.

Step 2: Define the driving forces: These are the high-level macro forces that can reshape the environment for any organisation – profit or not for profit. Just take a look at the headaches that I described when reading the *Financial Times* on 25th April. You should be able to identify these underlying or macro forces that kicked off each headache:

- (a) Economic pressures
- (b) Concern about environmentalism
- (c) Legislation and regulation
- (d) Political moves
- (e) The influence of technology
- (f) Socio-Demographic trends.

Together, these are known as the 'PESTEL' forces (Political, Economic, Socio-Demographic, Technology, Environmental and Legislative). These are the forces that working alone, or more usually together, can reshape our business environment.

Step 3: Issue Identification: - Looking at the global future and how the PESTEL forces have reshaped your industry in the past will give rise to a number of eventualities that could – positively or negatively – effect your business - if they materialised.

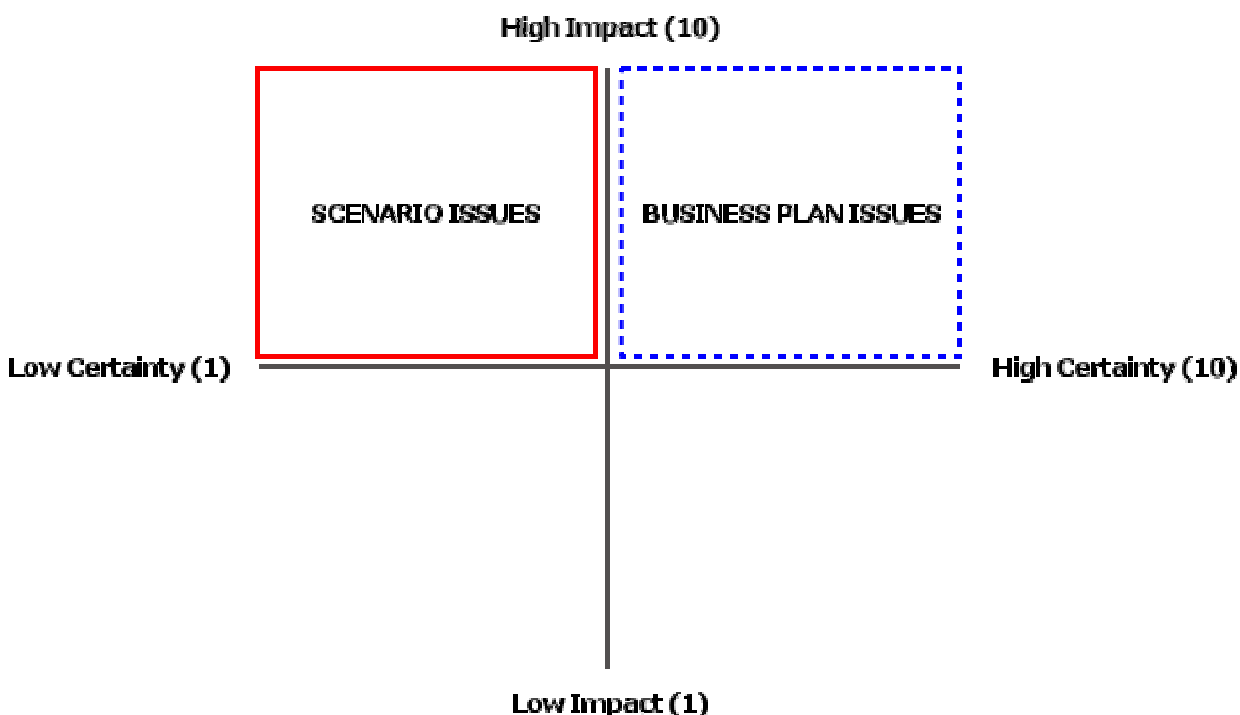
With members of your team, work up a list of possible events that concern you. These should be issues - events that if they happened could have a big impact on your business. Now, using the PESTEL model, identify the real driving forces behind each event. Examples of possible events are:

- (a) A prolonged recession - over 3 years.
- (b) The failure of a traditional core distribution channel.
- (c) New regulations restricting the sale of your product.
- (d) Restriction in energy supplies.

You can now frame these as a series of questions that you would like to explore.

Step 4: Isolating the major themes: Now take all the questions that you have identified in Step 3 and plot them on this 2 x 2 matrix:

ILLUSTRATION 2: IDENTIFYING THE BUSINESS SCENARIO ISSUES



You can see that the Y-axis - the vertical axis looks at the relative impact that each "question" will have on your business if it actually occurred. The relative impact can be decided in discussion just by using, for example, a 1 to 10 scoring scale where 1 = "relatively little impact" and 10 = "devastating impact - destroys our business model".

The X-axis running horizontally across the page looks at relative uncertainty. Here we are interested in how certain we are that the issue or eventuality described by your question will occur. The scoring runs from 1 ("little certainty" - where we probably just don't have enough information to make a judgement call) through to 10 ("high certainty" - we are confident that the issue will happen and therefore we know a lot about it to make this judgement call).

Now, we are interested in those issues in the top two boxes shown in Illustration 2 above. In the top right hand box we have high impact events that we are confident will occur. These are issues for your normal business planning process. If these events haven't been projected forward and taken into account when crafting your strategy there is something wrong with your planning process! For scenario building purposes, we are interested in exploring the questions in the top left hand quadrant. These are high impact events that we probably just don't know enough about and need further exploration.

Now look carefully at the questions that are in the top left hand box and consider the PESTEL forces that are driving each question. You will probably find that some questions may be inter-linked as they share the same driving forces. This will help you to cluster and reduce the number of eventualities or issues that you want to explore. At this stage you can call in someone who hasn't been involved in the process up to now to help you finally isolate the key questions in the top left hand box. It helps to get an outside view especially at this point.

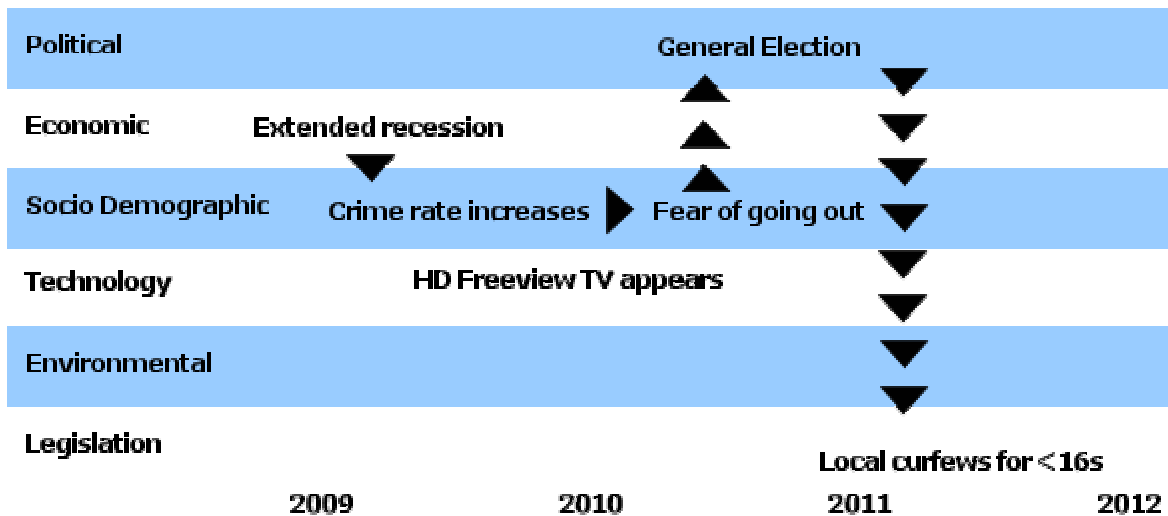
Step 5: Writing the Scenarios: Now we have a group of questions that we wish to explore from the top left hand box of our matrix. These cover our major uncertainties - if these eventualities actually happened, they would have a big impact on our business. From now on we will call these our scenario questions. These are the questions that we want our scenarios to look at. We also have decided what will, in the future, definitely happen - these are the in the top right hand box - and we will now call these the future certainties.

Now we can take one of the scenario questions and start to build a range of future scenarios to examine it in more detail and develop a view of the range of outcomes that we may face for that particular question if it actually occurred.

I like writing a scenario using a timeline that shows how the key driving PESTEL forces inter-act as the scenario unfolds over time. The future is rarely driven just by one force - looking at how forces inter-act over time produces a more realistic future view. This approach - using a timeline - makes for exciting development workshops and helps to increase the robustness of the outcomes that will be developed. Critically, it will help us to identify trigger points to look for to give us an early warning of when a particular scenario outcome is starting to develop. An example of a timeline for a scenario is shown overleaf. The driving forces - organised in their PESTEL categories - are shown vertically down the left hand side. The timeline runs from left to right. The illustration shows a *highly simplified* extract from a scenario looking at the future of home-based entertainment and you can see the inter-connected effects that have been assumed between different driving forces. Looking at multiple driving forces and their interaction adds a sense of realism.

Scenarios that only consider one driving force, such as technology, can look rather flat and unrealistic when they are presented.

ILLUSTRATION 3: SCENARIO TIMELINE EXTRACT - Future of home centric entertainment (simplified)



When you build your timelines for different scenarios that explore the range of outcomes for your scenario question, encourage people to consider extremes when thinking about the impact that driving forces may have. This helps you to develop a range of scenarios that embrace the breadth of possible futures.

Remember that scenarios don't have to be long documents. One page describing a scenario's outcomes, business impact and strategy implications is sufficient together with of course a page showing the timeline.

Step 6: Impact and responses: Now we have scenarios that describe the range of outcomes that we can expect we must consider the impact on the business. Think about these questions:

- (a) *What is the impact on our sources of competitive advantage?*
- (b) *How will our competitors act? Will we face new competitors? What will their sources of advantage be?*
- (c) *How should we change our strategy? What is our response plan?*
- (d) *What are the implications for our people, competences, culture, structure and processes?*

Answering these questions will help to ensure that we are better prepared for future uncertainties.

Step 7: Setting the early warning indicators: Finally, we need to know if a particular scenario is coming to fruition.

If you have build your scenarios using the cause and effect timelines, then identifying the key scenario "trigger points" show be easy.

Make sure that the trigger points are part of your information gathering and reporting system.

Conclusion: Scenarios and uncertainty

At this point we will have a greater understanding of the potential futures that our businesses could face.

Considering a range of potential futures, not just one, can help to build more resilient strategies and above all help your business to identify and react to major shifts in the outside world before your competitors do.

Finally

I hope that you have enjoyed this briefing.

You can find more on the website or e-mail me using the link below. I enjoy personally helping businesses - some of the work I undertake includes:

- § Forward looking business scenarios – what are your future challenges?
- § Facilitating board level strategic reviews, with a particular emphasis upon the definition of tomorrow's competitive environment
- § Design and implementation of Balanced Scorecard performance measurement systems
- § Research to help identify what potential capital providers will look for in your business plan
- § Training: Strategic Thinking, Scenario Planning, Performance Measurement and Strategic Change Workshops.
- § Product portfolio assessment. Helping the business to define the optimal product portfolio – balancing future competitive conditions with the probability of achieving future planned performance
- § Communication programmes
- § Organisational audits – assessing the innovative capability of your organisation

Best regards,

Robert Davies